REPORT BY THE

AUDITOR GENERAL

OF CALIFORNIA

A REVIEW OF THE OPERATIONS OF THE CALIFORNIA STATE UNIVERSITY AND COLLEGES' FOUNDATIONS

P-051

JANUARY 1982

REPORT OF THE

OFFICE OF THE AUDITOR GENERAL

TO THE

JOINT LEGISLATIVE AUDIT COMMITTEE

051

A REVIEW OF THE OPERATIONS OF THE CALIFORNIA STATE UNIVERSITY AND COLLEGES' FOUNDATIONS

JANUARY 1982

California Legislature

Joint Legislative Audit Committee

925 L STREET, SUITE 750
SACRAMENTO, CALIFORNIA 95814
(916) 445-0371

WALTER M. INGALLS
CHAIRMAN

January 20, 1982 051

The Honorable President pro Tempore of the Senate
The Honorable Speaker of the Assembly
The Honorable Members of the Senate and the
Assembly of the Legislature of California

Members of the Legislature:

Your Joint Legislative Audit Committee respectfully submits the Auditor General's report concerning California State University and Colleges' foundations. The report indicates that the foundations should remit to California State University campuses indirect cost recoveries in excess of those needed to keep the foundations financially solvent. Additionally, this report calls for more comprehensive guidelines on the proper use and control of foundation discretionary funds.

Respectfully submitted,

WALTER M. INGALLS
Chairman, Joint Legislative
Audit Committee

TABLE OF CONTENTS

SUMMARY

We have reviewed the operations of nine auxiliary organizations of the California State University and Colleges (CSUC) known as foundations. Although legally separate from the CSUC, foundations contribute to the educational mission of the university by administering research and special educational projects, organizing fund-raising efforts, and managing gifts, scholarships, and trust funds. Specifically, our review focused on the CSUC's recovery of indirect costs incurred in administering grants and contracts as well as the adequacy of policies and procedures governing foundations' operations and expenditures.

Both the campuses and the foundations within the CSUC incur costs associated with grants and contracts. Yet certain federal regulations and cost-sharing requirements prevent the CSUC from recovering the costs it incurs. And although the CSUC campuses generally incur most of these costs, the foundations retain the reimbursements. In fiscal year 1979-80, cost reimbursements to the nine foundations amounted to $5.2 million, a figure that greatly exceeds the foundations'

costs of administering grants and contracts. Moreover, these campuses only received $41,997 of this amount--a small portion of the actual costs they incurred. This practice is consistent with CSUC policy that foundations must remain solvent. However, upholding this policy may contradict another CSUC policy defining foundations as self-supporting.

Our review also focused on guidelines governing the use of discretionary funds, which include unrestricted donations and reimbursements of indirect costs. In the absence of explicit guidelines in this area, discretionary funds have been spent in a questionable manner. That is, foundations have financed items unrelated to educational objectives: banquets for faculty, season tickets to professional football games, and office decorations. Additionally, unrestricted donations have not been spent as indicated in fund-raising letters and pamphlets. And some discretionary funds have been spent for goods and services that would be denied state agencies. By making such purchases through the foundations, campuses have avoided the approval processes required for state agencies' expenditures.

Finally, our review showed that CSUC campuses have not established clear procedures for authorizing and documenting expenditures of discretionary funds. At the nine foundations we visited, employees responsible for authorizing

discretionary expenditures also receive such funds. And five of the nine foundations have not established procedures for documenting discretionary expenditures. We found that over 25 percent of the discretionary fund expenditures were either improperly authorized or inadequately documented.

To alleviate these problems, we recommend that the California State University and Colleges

- Receive the excess indirect costs recovered by the foundations;
- Establish specific guidelines on the proper use of discretionary funds;
- Ensure that foundations maintain specific procedures for properly authorizing and documenting discretionary expenditures.

INTRODUCTION

In response to a request by the Joint Legislative Audit Committee, the Office of the Auditor General has reviewed the programs and operation of auxiliaries to the California State University and Colleges known as foundations. This review was conducted under the authority vested in the Auditor General by Sections 10527 and 10528 of the Government Code.

Background

In this section, we discuss the origination and structure of the California State University and Colleges and give a functional definition of auxiliary organizations of the CSUC. We also describe the functions and operations of the campus foundations.

The Donahoe Higher Education Act of 1960 incorporated the individual California state colleges into one system. In 1972, the system was renamed the California State University and Colleges (CSUC). The primary function of the CSUC, which comprises 19 campuses with an enrollment of over 306,000, is to provide undergraduate and graduate instruction through the master's degree level. Additionally, the CSUC awards doctoral degrees jointly with the University of California or through

private institutions. The CSUC system is overseen by Trustees of the California State University and Colleges, members appointed by the Governor who in turn are responsible for appointing the chancellor, the chief executive officer of the system.

Within the CSUC system are 60 auxiliary organizations. These auxiliaries, which include campus-based foundations, are authorized by the Legislature to perform functions that contribute to the educational mission of the university or college. Auxiliary organizations operate as an integral part of the CSUC by conducting various campus support activities, such as directing student body functions, overseeing the operation of bookstores, and administering training agreements.

Twenty of the 60 auxiliary organizations are foundations--separate legal entities operating as private nonprofit corporations. The Chancellor's Office as well as all 19 campuses have foundations. These entities provide specific services to the CSUC based upon lease agreements with the university. Among other things, these agreements identify the campus functions the foundations will manage, the facilities available to the foundations, the rental amounts the

foundations will pay for using these facilities, and the terms by which the foundations will reimburse the CSUC for services performed by its employees.

Generally, campus foundations perform these functions:

- Receive gifts, scholarships, and other trust funds;
- Organize fund-raising activities within the university and colleges; and
- Seek funding for and administer research and special educational projects.

The foundations are separate legal entities that have a special relationship to the CSUC. The Education Code stipulates that foundations operate in conformance with the policies of the Trustees of the California State University and Colleges. Foundations are separate legal entities organized as nonprofit corporations under the California Corporations Code. Further, the Attorney General has affirmed this relationship by concluding that foundations are private, nonprofit organizations, usually in the form of corporations.

Accordingly, the foundations have their own sources of revenue. These include reimbursement for indirect costs on grants and contracts, contributions, income on investments, and service fees paid the foundations by other campus organizations. Moreover, CSUC policy, as stated in the Universities and Colleges Administrative Manual (UCAM) defines foundations as self-supporting entities.

Yet, foundations are an integral part of the CSUC. They exist to provide support services to the CSUC and to its campuses. New foundations may be created only if they receive the Chancellor's approval and, once foundations are in existence, they must comply with policies set by the Trustees. Additionally, campus presidents generally sit on the governing boards of foundations and also review the foundations' programs and budgets.

Scope of Review

During our audit, we reviewed the policies and procedures of the foundations of the CSUC, analyzed expenditures, and interviewed administrative staff at the Chancellor's Office and at these nine campus-affiliated foundations:

California State University, Chico

California State University, Fresno

California State University, Fullerton

California State University, Long Beach

California State University, Los Angeles

California State University, Sacramento

San Diego State University

San Francisco State University

San Jose State University.

These foundations handle most of the grants and contracts within the CSUC system. In fact, the aggregate amounts of grants and contracts they administered in fiscal year 1979-80 exceeded 77 percent of the total within the CSUC system, which equaled $50.2 million.

In conducting this audit, we reviewed whether the foundations have adequately reimbursed the CSUC for the indirect costs incurred on grants and contracts. To make this determination, we analyzed the computations of indirect cost recovery at the nine campuses for fiscal year 1979-80 and reviewed applicable regulations as well as federal guidelines dealing with the recovery of indirect costs.

We also reviewed the extent to which foundations controlled their expenditures for fiscal year 1979-80 and whether they complied with regulations in expending those funds. Furthermore, we examined expenditures to evaluate whether funds were disbursed in accordance with the policies and procedures of the foundations and the Board of Trustees and with Title 5 of the California Administrative Code and the Education Code. Finally, our examination helped us determine whether these disbursements were properly authorized and documented.

AUDIT RESULTS

ALTHOUGH REQUIRED TO BE SELF-SUPPORTING, FOUNDATIONS ARE FINANCIALLY DEPENDENT UPON THE CALIFORNIA STATE UNIVERSITY AND COLLEGES

Although the foundations administer grants and contracts within the CSUC, both the campuses and foundations incur indirect costs associated with this administration. Yet because of federal regulations and cost-sharing requirements, the foundations do not fully recover the costs that are collectively incurred. It is the campuses that bear the impact of this underrecovery even though their costs may exceed those incurred by the foundations. In fiscal year 1979-80, the nine foundations we visited recovered approximately $5.2 million in indirect costs. However, the nine campuses received only $41,997 although they incurred more indirect costs related to grants and contracts than did the foundations.

The inequitable reimbursement of indirect costs is in compliance with a CSUC policy that foundations remain solvent. Nonetheless, by adhering to this policy, the CSUC may be contradicting another policy defining foundations as self-supporting entities.

Foundations Receive
Payments for Administration
of Grants and Contracts

As mentioned in the Introduction, foundations administer research and training agreements within the CSUC system. These agreements are actually grants and contracts sponsored by federal, state, and local governmental agencies and by private organizations and involve direct and indirect costs. Both foundations and campuses incur indirect costs associated with these agreements. Direct costs, those which can be identified specifically with a project, include such items as salaries of project personnel and supplies or equipment purchased specifically for the project. Indirect costs, however, cannot be identified specifically with a particular project. These costs typically include those associated with general and departmental administration, student administration, and the operation and maintenance of campus facilities such as the library.

Foundations receive payments for both the direct and indirect costs of the research and training agreements that they administer. And although the foundations rely on several sources of revenue, including contributions and income on investments, they are primarily financed by reimbursements for

indirect costs. In fact, indirect cost reimbursements of $5.2 million represented 62 percent of the total unrestricted revenues the nine foundations received in fiscal year 1979-80.

Below we present the payments for research and training agreements the nine foundations received for the fiscal year ending June 30, 1980.

TABLE 1

PAYMENTS NINE FOUNDATIONS RECEIVED
FOR RESEARCH AND TRAINING AGREEMENTS
ACADEMIC YEAR 1979-80

Foundation	Direct Costs	Indirect Costs	Total
Sacramento	$ 3,536,630	$ 425,681	$ 3,962,311
Fresno	1,511,633	143,922	1,655,555
Fullerton	3,156,700	299,019	3,455,719
Los Angeles	5,072,358	660,948	5,733,306
Long Beach	3,809,282	365,329	4,174,611
San Jose	4,280,825	813,105	5,093,930
San Diego	10,650,496	1,400,280	12,050,776
Chico	1,972,365	337,315	2,309,680
San Francisco	4,819,116	718,762	5,537,878
Total	$38,809,405	$5,164,361	$43,973,766

For each campus, indirect costs are computed as a percentage of a project's direct costs or some component of the direct costs such as salaries and wages. This percentage is known as the indirect cost rate (ICR) and is a reasonable estimate of the total, combined indirect costs that a campus and a foundation incur in administering grants and contracts. As an example, if a sponsored project had an indirect cost rate of 35 percent and if its direct costs totaled $100,000, the administering foundation would receive $100,000 plus $35,000 or $135,000 for completing the project.

In the case of federal research agreements, the Federal Government requires an institution to develop an ICR proposal, which is subject to audit by a responsible federal agency. The Department of Health and Human Services is the federal agency responsible for negotiating indirect cost rates for the CSUC. When a CSUC foundation and the federal department agree to a given rate, sometimes referred to as the negotiated ICR, that rate applies to federal research agreements administered by that foundation. The federal negotiated rate is also sometimes applied to nonfederal projects.

CSUC Does Not Recover Total Costs of Administering Grants and Contracts

Despite attempts to negotiate an indirect cost rate that will reimburse the indirect costs associated with grants and contracts, the campuses and foundations within the CSUC are generally not reimbursed in accordance with their full indirect cost rates. As a result, the CSUC does not recover all of the indirect costs it incurs.* During fiscal year 1979-80, the nine California State universities we studied actually recovered indirect costs at rates that were considerably less than the negotiated indirect cost rates of any of these universities.

The CSUC is unable to recover indirect costs in accordance with its full indirect cost rate because some project sponsors do not provide full reimbursement and because of cost-sharing requirements. For example, when the foundation administers certain federal projects, it often receives only 8 percent of a project's total costs since federal agencies are limited by federal regulations in their indirect cost reimbursement. Furthermore, many nonfederal project sponsors do not reimburse the campuses for indirect costs in accordance with their full indirect cost rates. When not reimbursed in

---

* Appendix A gives the total amount of costs the CSUC was unable to recover in academic year 1979-80.

accordance with the full indirect cost rates, the CSUC cannot recover its actual costs. Additionally, the CSUC often absorbs a portion of a project's costs because project sponsors require that campuses share in those costs.

Foundations Retain Most of the Indirect Cost Reimbursements

In reviewing the negotiation of indirect cost rates between the foundations and project sponsors, we noted that although both the campuses and the foundations incur costs associated with grants and contracts, only the foundations receive payments for these costs. This section will demonstrate that foundations incur less in indirect costs than do campuses and that, after receiving indirect cost reimbursements, they retain most of these payments instead of directing some portion to the campuses. That the foundations retain these indirect cost reimbursements is consistent with CSUC policy requiring campuses to keep foundations financially solvent. Yet adhering to this policy may contradict another--that foundations should be self-supporting entities. In response to this dilemma, we propose that foundations remit to the campuses any excess reimbursements, thereby more equitably distributing these monies within the CSUC system.

Currently, the campuses do recoup a small portion of indirect cost reimbursements from foundations. Specifically, the CSUC collects from the foundations $0.57 per square foot per month for CSUC facilities devoted to certain federally sponsored special education projects. However, these are but a few projects administered by the CSUC. This $0.57 per square foot charge is the same rate the Department of General Services charges private organizations that occupy state facilities. For fiscal year 1979-80, the CSUC collected $41,997 in reimbursements for the use of campus facilities from the nine foundations we reviewed. This is a small portion of the indirect costs incurred by the CSUC in support of research and training agreements.

To determine the amounts of campus and foundation expenditures made in support of research and training agreements, we examined indirect cost rate proposals developed by three of the nine campuses we reviewed. These three campuses were selected because they used what is referred to as the long-form method in developing their proposals. This method requires the campuses to analyze the actual costs of indirect support provided to each major campus activity, including instruction, research, and other activities, as well as the most appropriate method of allocating these costs.

Furthermore, as part of this analysis, the campuses must compute the indirect expenditures made by the campus and the foundation in support of all federal and nonfederal agreements for the preceding fiscal year.

After reviewing the indirect cost rate proposal prepared by one of the three campuses, we were unable to determine the amount of indirect costs incurred. Thus, we analyzed the expenditures of two of the nine campuses.

Table 2 below summarizes the amounts of campus and foundation expenditures made in support of all research and training agreements for these two campuses. As shown, campuses A and B incurred a greater share of indirect costs than did their respective foundations.

TABLE 2

INDIRECT COSTS INCURRED
IN SUPPORT OF RESEARCH AND TRAINING AGREEMENTS
AT TWO CAMPUSES

	Campus A	Campus B
Indirect Costs Incurred by the Campus	$1,179,107	$1,400,012
Indirect Costs Incurred by the Foundation	417,318	409,256
Total Indirect Costs Incurred	$1,596,425	$1,809,268

Once we had determined the indirect costs incurred at these campuses, we compared those amounts with indirect costs recovered. As detailed in Table 3 below, the foundations retained all but a small portion of total indirect cost recoveries.

TABLE 3

INDIRECT COSTS INCURRED COMPARED WITH
INDIRECT COSTS RECOVERED ON
RESEARCH AND TRAINING AGREEMENTS
AT TWO CAMPUSES

	Campus A	Campus B
Indirect Costs Incurred by the Campus	$1,179,107	$1,400,012
Indirect Costs Recovered by the Campus	3,932	2,859
Indirect Costs Not Recovered	$1,175,175	$1,397,153
Indirect Costs Incurred by the Foundation	$ 417,318	$ 409,256
Indirect Costs Recovered by the Foundation	657,016	732,059
Excess Indirect Costs Recovered	$ 239,698	$ 322,803

To the extent that the foundations do not equitably share indirect costs recovered, the CSUC campuses are, in effect, subsidizing the foundations. For example, Table 3 shows that Campus A incurred $1,179,107 in indirect costs. However, the foundation remitted only $3,932 to the campus, a small fraction of Campus A's actual indirect costs.

Had the foundations reimbursed their respective campuses for the indirect costs the campuses incurred, the foundations would not have been able to cover their operating costs and thus remain solvent. According to CSUC policy, the campuses must ensure the "fiscal viability" of the foundations. But by adhering to this policy, the CSUC may be violating another university policy defining foundations as self-supporting entities.

In accordance with Board of Trustees' policy, the Chancellor has been delegated the responsibility of implementing financial standards that assure the fiscal viability of the foundations. Specifically, these standards should provide for

- Professional management;

- Adequate working capital;

- Adequate reserve funds for current operations and capital replacements; and

- New business requirements.

The Board of Trustees has also delegated to the Chancellor the responsibility of developing policies on the use of indirect costs recovered in excess of foundation costs. The campuses must report regularly to the Chancellor on the use of these funds.

However, allowing the campuses merely to report on the use of these excess funds rather than requiring the foundations to remit excess indirect cost recoveries to the campus could contradict CSUC policy defining foundations as self-supporting entities. Admittedly, the foundations cannot fully reimburse the campuses for campus costs without jeopardizing their own fiscal viability. Yet it would be more consistent with CSUC policies if foundations were to remit to the campuses any indirect cost recoveries in excess of those needed to keep the foundations solvent. Table 4 presents the amounts of indirect cost reimbursements that could be redirected to the two campuses.

TABLE 4

INDIRECT COSTS RECOVERED COMPARED
WITH INDIRECT COSTS INCURRED AT TWO CAMPUSES
ACADEMIC YEAR 1979-80

	Campus A	Campus B[a]
Indirect Cost Recoveries Retained by the Foundation	$657,016	$732,059
Indirect Costs Incurred by the Foundation	417,318	409,256
Indirect Cost Recoveries in Excess of Foundation Costs	$239,698	$322,803

[a] The data for this campus are from fiscal year 1978-79.

As illustrated, the two campuses could have recouped a total of $562,501 in indirect cost reimbursements.

CONCLUSION

Although defined as self-supporting entities, foundations are financially dependent upon the California State University and Colleges. Both CSUC campuses and foundations incur costs associated with grants and contracts; however, the campuses do not recover their share of these costs. This is consistent with CSUC policy that campuses must ensure

that the fiscal viability of the foundations is maintained. Yet upholding this policy may contradict another CSUC policy that defines foundations as self-supporting entities.

RECOMMENDATION

We recommend that the CSUC revise its policy on excess indirect cost recoveries. Rather than requiring the foundations merely to report on the use of these funds, the foundations should be allowed to retain indirect cost recoveries sufficient to maintain the fiscal viability of the foundations. Indirect cost recoveries in excess of this should revert to the campuses. To implement such a policy, the Chancellor should develop specific guidelines regarding the allowable costs associated with maintaining a foundation's fiscal viability.

THE CALIFORNIA STATE UNIVERSITY AND COLLEGES HAS NOT ISSUED EXPLICIT GUIDELINES ON THE PROPER USE OF DISCRETIONARY FUNDS

The California State University and Colleges has not issued explicit guidelines on how foundations may use discretionary funds, which include indirect cost reimbursements as well as unrestricted donations. In the absence of these guidelines, we noted expenditures of discretionary funds that may not be consistent with the educational objectives of the CSUC. We also found that donations are not being expended as described in fund-raising literature. Finally, some discretionary funds have been spent for goods or services that would be denied state agencies. By making such purchases through the foundations, campuses are able to circumvent state procedures.

Section 89904 of the Education Code requires the Board of Trustees to assure that foundation monies are spent to advance the educational objectives of the CSUC. To implement this section, the CSUC has established some guidelines to control expenditures of foundation funds. These requirements include the following:

- Each foundation's Board of Directors must approve all expenditures for public relations or for other purposes that would serve to augment state appropriations for the operation of the campus;

- Each campus is required to report to the Chancellor on the use of indirect cost reimbursements;

- The expenditure of certain foundation funds is jointly controlled by the campus and the foundation; that is, the disbursement of these funds typically requires both the approval of the requisite campus and foundation officials;

- Each campus is required to file with the Chancellor a statement of policy on the accumulation and use of public relations funds;

- Each campus is required to formulate a statement of policy on the accumulation and use of discretionary funds.

Although each campus is required to formulate policies on the proper use of discretionary and public relations funds, these policy statements are broad enough to have allowed numerous questionable expenditures that may not be consistent with educational objectives of the campus. For

example, these statements allow expenditures not only for faculty and student projects, scholarships, and public relations, but also for staff banquets and office decorations.

We reviewed discretionary fund expenditures totaling $1.04 million. Of the $1.04 million, $153,000 was spent to benefit CSUC employees, $306,000 was expended to improve public relations, and $345,000 was spent to cover miscellaneous items such as faculty travel, office equipment, and furniture. We found that some of these expenditures were unrelated to educational objectives. Examples of questionable expenditures were luncheons and dinners for spouses of faculty and administrators, refreshments at faculty and staff meetings, floral arrangements and corsages, office decorations, and season tickets to professional football games.

Many of the expenditures we questioned at the campuses appeared to benefit CSUC employees. In reviewing accounts for fiscal year 1979-80, we identified over $99,000 in questionable discretionary expenditures that solely benefitted CSUC employees. All nine campuses spent discretionary funds on faculty and staff luncheons, parties, or banquets. In some instances, campuses purchased food, refreshments, and decorations for Christmas and year-end parties for faculty and staff, paid for office staff luncheons, and financed department dinner meetings.

In responding to our questions about these expenditures and how they furthered the educational objectives of the CSUC, campus officials provided a variety of responses. Several officials indicated that such events help build faculty and staff morale as well as foster good working relationships and loyalty to the university. Other campus representatives pointed out that universities traditionally host such events, which are a regular and expected part of the social and cultural affairs of a university. Campus officials also indicated that these expenditures were justified and in accordance with CSUC and foundation policy.

We also noted that campuses are not spending donated funds as indicated in fund-raising literature. Two of the five foundations that participate in fund-raising campaigns expend only small portions of the solicited funds for the purposes stated in fund-raising literature. This practice could jeopardize future fund-raising efforts.

During fund-raising activities at one campus, solicitation letters mailed to prospective donors stated that donated funds would be used for these purposes:

- Supporting faculty teaching and research efforts;

- Purchasing research equipment;

- Assisting gifted students in their education; and

- Enriching established programs.

Yet, of the $12,500 collected for these purposes, $5,100 was spent on public relations activities, such as entertaining campus officials and guests.

Another campus mailed solicitation letters requesting money to fund scholarships, research, student activities, and awards, but almost half of the funds collected were spent on public relations activities, including other fund-raising campaigns.

Finally, some discretionary funds have been spent for goods or services that would be denied state agencies. We noted that all nine campuses purchased such goods or services through CSUC foundations, thereby avoiding the approval processes required for state agencies' expenditures.

As an example, campuses spend discretionary funds for faculty recruitment. During 1979-80, the nine campuses spent over $54,000 in discretionary funds on faculty recruitment activities. Over $22,000 or 41 percent of these expenditures exceeded limits placed on such expenditures by the State Board of Control.

Similarly, discretionary funds are spent for faculty travel. During 1979-80, the nine campuses spent over $107,000 in discretionary funds for faculty travel. Over $12,000 or 11 percent of these expenditures exceeded limits placed on such expenditures by the State Board of Control. Some of these expenditures are clearly questionable in view of the educational objectives of the CSUC. The CSUC needs explicit guidelines in this area to ensure that campuses will spend discretionary funds to meet the educational objectives of the university.

CONCLUSION

The CSUC has not issued specific guidelines on the proper use of discretionary funds. Without such guidance, CSUC campuses are spending discretionary funds in ways that may not be consistent with the CSUC's educational mission. Additionally, CSUC campuses are not using donations as indicated in fund-raising literature. Finally, campuses are using these funds to purchase goods or services that would be denied state agencies, a practice that circumvents state procurement procedures.

RECOMMENDATION

We recommend that the California State University and Colleges establish explicit guidelines to ensure that

- Discretionary funds are spent in ways that further essential educational objectives of the CSUC;

- Discretionary funds are not used to circumvent state control procedures.

THE CALIFORNIA STATE UNIVERSITY AND COLLEGES HAS NOT ESTABLISHED SUFFICIENT PROCEDURES TO CONTROL DISCRETIONARY FUND EXPENDITURES

Campuses of the California State University and Colleges have not established sufficient operating procedures for properly authorizing expenditures of discretionary funds. Specifically, at all nine foundations, we noted that employees responsible for authorizing discretionary expenditures also receive these funds. Additionally, five of the nine foundations have not established complete procedures for documenting discretionary expenditures. In the absence of sufficient operating procedures, we found that over $262,000 of the $1.04 million in discretionary fund expenditures was either improperly authorized or inadequately documented. The incidence of inadequate documentation or authorization of expenditures among the nine campuses ranged from a low of 11 percent to a high of 48 percent.

Inadequate authorization and documentation of discretionary expenditures are weaknesses in the CSUC foundation's system of internal accounting control. The objective of a system of internal accounting control is to provide management with reasonable assurance that assets are safeguarded against loss and that transactions are executed in accordance with management's authorization. Weaknesses in the foundation's system of internal accounting control could

jeopardize the achievement of these objectives. The management of each campus foundation is responsible for establishing and maintaining a system of internal accounting control.

One element of good internal accounting control is the proper segregation of certain duties involving the receipt of, accounting for, and expenditure of funds. However, under current procedures at all nine foundations, campus officials who authorize disbursements may also receive these funds. This practice occurs when a campus official responsible for discretionary funds makes a purchase using personal funds and then seeks reimbursement. Thus, the individual being reimbursed for out-of-pocket expenses is also responsible for approving the disbursement.

Another element of good internal accounting control relates to the documentation of expenditures. Only four of the nine campuses we reviewed have formulated sufficient operating procedures for properly documenting discretionary fund expenditures. Regulations pertaining to state agencies, however, provide suitable guidelines for documenting expenditures of this nature. State regulations require that certain types of expenditures be supported by the following information: the date and purpose of the transaction, the individuals involved, and the amount of each expenditure.

Using these state regulations as our standard, we examined discretionary expenditures during fiscal year 1979-80. We often found that foundations had not clearly stated the purpose of the expenditures, had not listed the names of persons benefitting from public relations and recruiting expenditures, or had not attached valid receipts supporting the expenditures.

Our findings were supported by the results of a 1980 audit conducted by auditors of the Board of Trustees. In reviewing two of the four campuses we studied, the auditors noted insufficient documentation of foundation expenditures and recommended that foundations strengthen operating procedures to assure that expenditures are properly supported. At one of the other foundations, the auditors found that the foundation was "maintaining a high standard of record-keeping."

Additionally, we found that three other foundations with complete operating procedures covering the proper documentation of expenditures were among those having the smallest dollar totals of inadequately documented expenditures.

CONCLUSION

In the absence of sufficient operating procedures for the proper authorization and documentation of expenditures, CSUC campuses are often not properly authorizing or documenting expenditures of discretionary funds. Inadequate authorization and documentation of discretionary expenditures are weaknesses in the foundation's system of internal accounting control.

RECOMMENDATION

We recommend that the California State University and Colleges take action to control expenditures of discretionary funds. The Chancellor should require all CSUC foundations to establish sufficient operating procedures for properly authorizing and documenting discretionary expenditures.

Respectfully submitted,

Thomas W. Hayes

THOMAS W. HAYES
Auditor General

Date: December 30, 1981

Staff: Thomas A. Britting, Audit Manager
Steven M. Hendrickson
Albert M. Tamayo
Irving Eachus
Bernice Ericksmoen

THE CALIFORNIA STATE UNIVERSITY AND COLLEGES

BAKERSFIELD - CHICO - DOMINGUEZ HILLS - FRESNO - FULLERTON - HAYWARD - HUMBOLDT
POMONA - SACRAMENTO - SAN BERNARDINO - SAN DIEGO - SAN FRANCISCO - SAN JOSE

LONG BEACH - LOS ANGELES - NORTHRIDGE
SAN LUIS OBISPO - SONOMA - STANISLAUS

OFFICE OF THE CHANCELLOR
(213) 590-5501

Mr. Thomas Hayes
Auditor General
925 "L" Street
Suite 750
Sacramento, California 95814

December 22, 1981

Dear Mr. Hayes:

We have received a draft copy of the audit entitled "A Review of the Operations of the California State University and Colleges' Foundations", dated December 1981. We appreciate the opportunity to have reviewed the draft and to have discussed it with you and members of your staff. I am pleased that in our meeting you reflected a comprehensive understanding of the importance of foundations and of their benefits to the CSUC campuses upon which they are located. As you know, foundations perform many useful and essential functions. Often the greatest values which the foundations contribute to the campuses cannot be added up in dollars and cents. There are numerous ways the foundations assist campuses in achieving their educational missions. We would hope your remarks are put in a context that would permit the reader of your report to be aware of this.

Moving to the report and the findings regarding the first recommendation, the auditors use the indirect cost rate proposals developed by three of the nine campuses reviewed to calculate the actual indirect support provided to each major campus activity including instruction, research and other activities. The audit states that indirect costs (Table 2, page 14) were incurred by CSUC to support each foundation's research and training activity. This is perhaps misleading. The costs identified in the table are regular instructionally-related costs of the education program of each respective campus. They are neither increased nor decreased by foundation agreements with the Federal government. There are no State funds expended to subsidize the foundations and thus they are self-supporting within the intent of Trustee policy.*

---

*Auditor General Comment: As pointed out on page 14 of our report, campuses using the long-form method of developing indirect cost rates do in fact compute the amounts of indirect expenditures that they make in support of foundation activities. Indirect costs of each campus are supported by state funds; thus, those indirect costs that are not reimbursed by the foundations constitute a subsidy.

More importantly, the indirect costs incurred by the foundations (Table 2, page 14) are substantially understated. Those included in the table are only each foundation's indirect costs as specified in Federal regulations. Not included are provisions for working capital, cost-sharing requirements, program development or new business, and other necessary expenditures and reserves. These are ordinary and necessary business expenses and are in compliance with Education Code requirements. The audit focused its attention primarily on research and training agreements and did not include other functions performed by the foundations.

The first part of the report includes the following recommendation:

> We recommend that the CSUC revise their policy on excess indirect cost recoveries. Rather than requiring the foundations to merely report on the use of these funds, the foundations should be allowed to retain indirect cost recoveries sufficient to maintain the fiscal viability of the foundations. Indirect cost recoveries in excess of this should revert to the campuses. To implement such a policy the Chancellor should develop specific guidelines regarding the allowable costs associated with maintaining a foundation's fiscal viability.

Response

We concur with the recommendation to develop specific guidelines regarding the allowable costs associated with maintaining a foundation's fiscal viability. It should be recognized in developing these guidelines for indirect cost recoveries that: no State funds are provided to support the foundation programs which are critical to the CSUC educational mission; foundation costs substantially exceed those identified in the audit as outlined above; foundations are self-supporting in accord with the Education Code and Trustee policy, and finally, the foundations must utilize indirect cost reimbursements to insure the fiscal viability of all of their authorized functions, not only research and training.

The recommendation dealing with expenditure of discretionary funds states:

> We recommend that the California State University and Colleges establish explicit guidelines to ensure that
>
> - Discretionary funds are spent in ways that further essential educational objectives of the CSUC; and
>
> - Discretionary funds are not used to circumvent state control procedures.

Response

We concur. Together with appropriate campus personnel, we will define the use of discretionary funds consistent with the objectives of CSUC. We will also review and reissue CSUC policies which address circumvention of State control procedures.

The last section of the report involves control and documentation of discretionary fund expenditures. The related recommendation states:

> We recommend that the California State University and Colleges take action to control expenditures of discretionary funds. The Chancellor should require that all CSUC foundations establish sufficient operating procedures for properly authorizing and documenting discretionary expenditures.

Response

We concur. We will issue a policy statement requiring that the foundations modify their operating procedures to provide for satisfactory authorization and documentation of discretionary expenditures.

Sincerely,

Glenn S. Dumke
Chancellor

GSD:pg

cc: Mr. John F. O'Connell

COMPARISON OF INDIRECT COSTS COMPUTED AT FULL INDIRECT COST RATE TO ACTUAL INDIRECT COSTS RECOVERED ON GRANTS AND CONTRACTS AT NINE CAMPUSES

Campus	Indirect Cost Recoveries at Full Indirect Cost Rate[a]	Indirect Costs Recovered	Amounts Not Recovered	Total Underrecovery
A	$1,289,490	$ 660,948	$ 628,542	
B	1,387,263	813,105	574,158	
C	3,374,200	1,400,280	1,973,920	
D	760,604	425,681	334,923	
E	303,928	143,922	160,006	
F	715,617	299,019	416,598	
G	849,900	365,329	484,571	
H	665,764	337,315	328,449	
I	1,554,393	718,762	835,631	
				$5,736,798

[a] This is the amount that the CSUC would have recovered had it received the full indirect cost rate on all grants and contracts administered, rather than on just a few of the federal grants.

cc: Members of the Legislature
Office of the Governor
Office of the Lieutenant Governor
State Controller
Legislative Analyst
Director of Finance
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps

The first five copies of each California State Auditor report are free. Additional copies are $3 each, payable by check or money order. You can obtain reports by contacting the Bureau of State Audits at the following address:

California State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, California 95814
(916) 445-0255 or TTY (916) 445-0033

OR

This report is also available on the World Wide Web
http://www.bsa.ca.gov/bsa/

The California State Auditor is pleased to announce the availability of an on-line subscription service. For information on how to subscribe, please contact the Information Technology Unit at (916) 445-0255, ext. 456, or visit our Web site at www.bsa.ca.gov/bsa

Alternate format reports available upon request.